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TAGS: [ENRG](#) [EPET](#) [AJ](#) [KZ](#) [ECONOMIC](#)

SUBJECT: KAZAKHSTAN: PARTIES INITIAL KCTS IGA DRAFT

REF: A. ALMATY 2833

[B](#). BAKU 1434

[C](#). BAKU 1224

Classified By: POEC chief Deborah Mennuti, reasons 1.4(B) and (D)

[¶1.](#) (C) Summary: Kazakhstani and Azeri negotiators approved and initiated a draft of the Kazakhstan Caspian Transportation System (KCTS) Inter-governmental Agreement (IGA) in Almaty on September 24. The delegations agreed upon a single text, though the GOK delegation insisted on highlighting a few passages -- including a key one on ratification -- as being "subject to the approval of the governments." The Azeri delegation, in turn, linked eventual GOA signature of the IGA to promised GOK steps to correct recent flawed legislation which, as passed, appears to question the primacy of international treaties over national legislation (Ref A). After a difficult first day of negotiations, the parties advanced quickly toward agreement following the Azeris' surprising embrace of the GOK's proposed language on taxation. The IGA language grants project investors apparent tax stability (promising that any new tax will preserve "the balance of economic interests") while subjecting the investors to national tax legislation, except as otherwise stated in the future Host Government Agreements (HGAs). Lead investor negotiator Fabrice Mosneron-Dupin told Econoff that, while agreed-upon position on taxes would render HGA negotiations long and difficult, the investors had chosen not to "go to the mat" on the issue, preferring to use their leverage to clarify recently-discovered ambiguous language in the definition of the scope of the Trans-Caspian system. End Summary.

Kazakhstanis Concede Recent Legislation Flawed

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[¶2.](#) (C) During a September 22 "pre-negotiation" meeting with investor representatives, GOK Delegation Head Kairgeldy Kabyldin and Ministry of Foreign Affairs (MFA) representative Erkin Akhinzhanov acknowledged that the August 2005 Kazakhstan Law on International Treaties contained a "technical error." This law, which as passed appeared to subordinate international treaties to domestic legislation, had provoked a storm of pre-negotiation protest from SOCAR (Ref B) and project investors. The next day, during negotiations, Akhinzhanov confirmed that the Kazakhstan parliament would pass an amendment rectifying the mistake, and promised the Azeri negotiating team (lead by SOCAR president Natik Aliyev and, as a vocal second, Gia Chanturia) a formal, written response from the MFA and the Constitutional Council.

[¶3.](#) (C) While both the Azeris and the investors seemed to accept the GOK's good-faith explanation of the offending legislation, the Azeri delegation at first insisted that the Kazakhstan parliament would have to amend the law before the GOA would sign the IGA. When Akhinzhanov replied that the parliament was unlikely to do so before "the first of the year," Michael Townsend (BP president in Azerbaijan, and a member of the Azeri team) suggested that the Azeri position would depend on the adequacy of the formal, written GOK response to SOCAR's letter. Later in the negotiations the Azeris proposed an additional sub-article (6.3.2) to the IGA binding governments to "take all necessary measures to ensure that there shall be no national legislation that could have the effect of amending, suspending, terminating, and/or otherwise frustrating this treaty and its implementation." (Note: This clause is one among those "subject to approval by the governments." While the GOK unwaveringly acknowledged that the law was flawed, at times -- particularly when the negotiations were tense -- GOK negotiators asserted that, since the flawed law was clearly unconstitutional, both amendment and the proposed 6.3.2 were superfluous. End Note.)

Breakthrough on Taxation

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[¶4.](#) (C) The parties repeatedly deferred discussion of taxation until September 24, clearly anticipating a difficult negotiation. In fact, the Azeris quickly agreed to the GOK's proposed text, which subjects the investors to national (tax) legislation, except for what is specifically exempted in the

(future) HGAs. (Note: In May, the parties initiated an IGA

embodying the opposite approach (Ref C): except as provided for in the HGA, parties would be exempt from taxes. End Note.) In explaining the Azeris' assent to the GOK position, Aliev suggested that "it is up to each government" to decide what concessions to make to the oil companies; thus, the proper place to address the issue was in the HGAs. Kabyldin argued that the investors' approach would "never make it past the Ministry of Finance;" on cue, the attending MOF representative agreed, underscoring his Ministry's view that a global exemption from taxes was inappropriate for an IGA which would potentially cover many future projects, all detailed in separate HGAs. Better, he said, to negotiate specific project concessions in an HGA.

15. (C) In response, Dupin argued that the GOK approach was more complicated than the investor's version, and would lead to drawn-out HGA negotiations. "We're not experts in Kazakhstani tax law," he protested, noting that, under the GOK approach, lawyers for the investors would have to study "more than 100 Kazakhstani taxes" and their potential impact on the project. In the corridor, however, Dupin was less strident, telling Econoff that "we still can get what we need during the HGA negotiations." Conoco-Phillips' representative Hakim Janah (strictly protect) was less sanguine, protesting during the negotiations and privately telling Econoff that he was frustrated with "Dupin and the other TOTAL representatives" for having "conceded too easily."

16. (C) The parties scarcely discussed the specific issue of tax stability. The investors accepted the GOK's basic language: "...stability of the Tax Regime implies, *inter alia*, the non-application of new Taxes, with the exception of cases where such Taxes are a replacement of previously existing ones, whilst preserving the balance of economic interests." When Econoff asked Janah whether the last phrase was sufficiently well-defined to avoid future disputes, Janah assured him that the term was "widely used and accepted in the industry" and thus was not vulnerable to manipulation.

#### Ambiguity in Definition of Trans-Caspian System

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17. (C) Dupin told Poloff that his primary goal during the negotiations was to clarify certain "ambiguities" which the investors' lawyers had discovered after the May negotiations in the text defining the "Trans-Caspian System." In English, at least (both the GOK and the GOA insisted that the problem did not exist in the Russian version), the draft May IGA inadvertently required future GOK assent to fundamental aspects of project infrastructure which were, in fact, being agreed upon in principle upon signature of the IGA (with project details to follow in the HGA). At one point during this debate Aliev remarked that the investors' "insistence on a purely linguistic point gives me suspicions," but in the end compromise language was found.

#### Ratification: Much Ado About "Temporary"

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18. (C) Perhaps the most contentious issue during the negotiations was how to define the ratification process. All sides professed to support the same process: the IGA would come into effect upon signature, but not prevail over national legislation (i.e., operate as a treaty) until ratified. The investors and Azeris, however, were troubled in general by the effect of the flawed legislation (paragraphs 2-3 above), and specifically by GOK inclusion of a clause (in English) which rendered initial application of the Treaty "temporary," without seeming to specify an end to the "temporary" status. The Kazakhstani side, on the other hand, argued that they had taken the questioned phrase "straight from the Vienna Convention." Only after a breakthrough on the tax issue softened the tenor of the negotiations did the GOK accept to insert the investors' alternative text "subject to approval of the governments."

19. (C) Note: Only at the beginning of the negotiations did Aliev mention the newly-created Azeri "Presidential Commission" on negotiations (Ref B), commenting that the commission had been created "not just for negotiations," but to "resolve all questions related to the transport of Kazakhstani oil," particularly those "in the implementation stage, such as permits and the allocation of land."

110. (C) Comment: The GOK tactic of bracketing several IGA phrases as "subject to approval by Governments of Kazakhstan and Azerbaijan" is, in once sense, a truism, but likely also represents Kabyldin and company's recognition that they may have been negotiating beyond their instructions or competency, especially in accepting Article 6.3.2. as penance for the flawed GOK legislation. We don't expect signature anytime soon, as the Azeris demanded that the GOK produce at least a formal explanation of the flawed legislation, if not

an amendment. However, the GOK did get what it seemed to want most out of this negotiation -- no blanket exemption on taxes for project investors -- and thus may be in a mood to compromise on the issues "subject to government approval."

End Comment.

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